



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

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No. 80/39

March 7, 1980

TO COUNTY ASSESSORS:

CHANGE IN OWNERSHIP - CORPORATE STOCK TRANSFERS

Legislative implementation of Proposition 13 provides that with one enumerated exception transfers of ownership interests in corporations, partnerships and other undesignated similar legal entities are not to be considered changes in ownership prompting reappraisal of real property owned by the entity, the interest in which has transferred. The exception, which is contained in Section 64(c) of the Revenue and Taxation Code, has been the source of a number of inquiries because of the reference to director-owned shares, to wit:

"(c) When a corporation, partnership, other legal entity or any other person obtains control, as defined in Section 25105, in any corporation through the purchase or transfer of corporate stock, exclusive of any shares owned by directors, such purchase or transfer of such stock shall be a change of ownership of property owned by the corporation in which the controlling interest is obtained." (Underscore added.)

Obviously, the exclusion from consideration of director-owned shares could be read to apply to directors of either the acquiring company or the acquired company. If the language is viewed as meaning directors of the acquired corporation, it would result in what we regard as an unwarranted result. For example, if all the voting stock in the Widget Corporation is owned by its only directors A, B, and C and they collectively sell all of their shares to the Blodget Corporation, no change of ownership would be deemed to have occurred even though ownership and control, as defined in Revenue and Taxation Code Section 25105, of all the Widget assets have been obtained by the buyer. The logic of such a result escapes us and we can find no legislative history to indicate such an interpretation was intended.

Section 64(c) speaks mainly of an acquiring person or corporation. It is our view, therefore, that the director referred to in the section would be the director of an acquiring corporation. The purpose of the exclusion would be to avoid adding all shares owned by both the corporation and the shares owned by the director of that corporation together to determine if control is gained of the acquired corporation. Such an interpretation recognizes the separateness of the corporation and its director and does not charge the corporation or the director with the ownership or control of property they do not, in fact, own or control simply because of their relationship to one another. This interpretation is also consistent with the legislative

TO COUNTY ASSESSORS

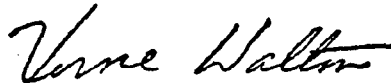
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March 7, 1980

history in Section 64(c) because prior to the amendments in AB 1019, the section referred only to corporations that acquire control of another corporation.

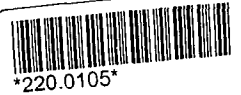
When looking at the acquired corporation, all stock of that corporation, held by directors or others, must be totaled when purchased by a single person or entity to determine if control has transferred. If two individuals were to separately purchase 15 percent and 40 percent respectively of the voting stock in a corporation, there would be no basis for concluding that control by the corporation has been transferred to a single person or entity. On the other hand, if an individual purchases 15 percent of a corporation's stock and a corporation purchases 55 percent of that corporation's stock, it is the second transfer that comes under Section 64(c). It is important to remember whenever there is a change in ownership of a corporation all of the corporate property is reappraised regardless of the percentage of stock that was acquired and resulted in obtaining of control; e.g., if A owns 45 percent of a corporation's stock and then obtains 10 percent more, all corporate taxable assets would be subject to reappraisal.

Sincerely,



Verne Walton, Chief
Assessment Standards Division

VW:sk



April 11, 1983

Eric P. Eisenlauer

Change in Ownership - S. Property

This is in reply to your memo of March 10 in which you ask whether there has been a change of ownership with respect to S. Company under the facts which follow.

Prior to June 16, 1982, F. was the owner of record of 235,514.70 shares of the voting stock of S. Company, which amounted to 28.9 percent of the outstanding shares.

On June 16, 1982, F.'s brother, Everette, died. At that time, E. and his wife owned, as their community property, voting shares totalling 407,337.53 or 49.9 percent of the outstanding voting stock of S. Company. In his will, E. created two trusts which contained both his and his wife's community property interest in the stock. E. named his brother F. and his daughter B. as co-executors and co-trustees of the trusts. E.'s wife was beneficiary of one trust, and his children and the issue of any deceased child the beneficiaries of the other trust.

In October, 1982, F. and his son, F. S. shifted control of the corporation to themselves by voting to sell 135,294.12 shares of unissued voting stock to F. and by electing F. president of the corporation. The additional shares raised F.'s total record ownership (exclusive of his ownership as a fiduciary) to 420,808.82 shares or 42 percent and shifted majority ownership of the shares from E. family to F.'s family. This power play was apparently made possible by F.'s ability to vote the shares in E.'s estate (or part of them) in his capacity as co-executor or co-trustee.

The question raised by the foregoing facts is whether F. obtained control in S. Company through the transfer of stock to him as a co-executor or co-trustee

April 11, 1983

as a result of the death of E . If so, there has been a change of ownership of property under Revenue and Taxation Code Section 64(c).

Corporations Code Section 702(a) provides:

"Subject to subdivision (c) of Section 703, shares held by an...executor...may be voted by such holder either in person or by proxy, without a transfer of such shares into the holder's name; and shares standing in the name of a trustee may be voted by the trustee, either in person or by proxy, but no trustee shall be entitled to vote shares held by such trustee without a transfer of such shares into the trustee's name."

Section 704 provides in part:

"If shares stand of record in the names of two or more persons, whether fiduciaries, members of a partnership, joint tenants, tenants in common, husband and wife as community property, tenants by the entirety, voting trustees, persons entitled to vote under a shareholder voting agreement or otherwise, or if two or more persons (including proxyholders) have the same fiduciary relationship respecting the same shares, unless the secretary of the corporation is given written notice to the contrary and is furnished with a copy of the instrument or order appointing them or creating the relationship wherein it is so provided, their acts with respect to voting shall have the following effect:

"(1) If only one votes, such act binds all;

"(2) If more than one vote, the act of the majority so voting binds all;

"(3) If more than one vote, but the vote is evenly split on any particular matter, each faction may vote the securities in question proportionately...."

April 11, 1983

Corporations Code Section 702(a) makes it clear that either an executor or a trustee can vote the shares he holds although a trustee must hold the shares in his name to vote.

Here F is co-executor and co-trustee with B. Conceivably, B might want to vote the stock differently from F. In such event, Corporations Code Section 704(3) provides that each fiduciary may vote proportionately. In that case, F would be entitled to vote one-half of the shares as a co-executor or co-trustee. As a fiduciary, therefore, F has the right to vote at least 203,668.76 shares of S Company stock. At the time F became co-executor, he was also entitled to vote 235,514.70 shares which he owned of record in his own right. (Corporations Code Sections 185 and 701(d).) Thus, upon becoming co-executor of the estate of E, F became entitled to vote a total of 439,183.46 shares of S Company stock, which shares exceeded 50 percent of the outstanding shares at that time.

For purposes of Section 64(c), control is defined in Section 25105, which states that ownership or control is "Direct or indirect ownership or control of more than 50 percent of the voting stock of the [corporation]...." Although there are no published appellate decisions interpreting Section 25105, the section has been considered in Appeal of Signal Oil and Gas Company, etc., Cal. St. Bd. of Equal., September 14, 1970, a franchise tax case dealing with the question of whether there are circumstances where controlling ownership can exist in the absence of majority ownership. In reaching an affirmative answer, the Board stated:

"In order to obtain guidance for decision of the instant appeal it is necessary to examine provisions of statutes whose purpose and procedure are somewhat analogous to those of the unitary business concept of section 25101. Such similarity is present in sections 24725 and 25102 of the Revenue and Taxation Code which are concerned with clearly reflecting the income of affiliated taxable entities, and authorize the use of allocation of income to accomplish this purpose. The scope of both sections is defined in terms of taxable entities '...owned or controlled directly or indirectly by the same interests....' (Emphasis added.)

April 11, 1983

"In reference to the ownership or control required by section 25102, section 25105 of the Revenue and Taxation Code states:

'Direct or indirect ownership or control of more than 50 percent of the voting stock of the taxpayer shall constitute ownership or control for the purposes of this article.'

"Section 482 of the Internal Revenue Code of 1954 is the almost identically worded federal counterpart of section 24725. Treasury regulation section 1.482-1(a) (3) provides in part:

'The term 'controlled' includes any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised. It is the reality of the control which is decisive, not its form or the mode of its exercise....' (Emphasis added.)

"In Charles Town, Inc. v. Commissioner, 372 F.2d 415, cert. denied, 389 U.S. 841 [19 L. Ed. 2d 104], two shareholders controlled one of the two relevant corporations but only owned 2 percent of the stock of the other. The United States Court of Appeals held that notwithstanding this minority ownership the above stockholders were in effective control of the latter company, and application of section 482 was sustained. A primary source of this effective control was found in an agreement executed by the majority shareholder."

- B. Bittker and J. Eustice, Federal Income Taxation of Corporation and Shareholders, (4th Ed. 1979), make the following statement with respect to Internal Revenue Code Section 482 at page 15-20:

"One of the necessary ingredients for the application of Section 482 is that the organizations dealing with one another be owned or controlled directly or indirectly, by the same interests. This aspect of the section,...is of broad and indefinite sweep.

April 11, 1983

The use of the disjunctive in stating that either common ownership or common control will support application of the section indicates that the fact of control alone should be sufficient for this purpose. Moreover, the term 'indirectly' suggests that ownership attribution should be relevant in this context. Although it is clear that the full panoply of constructive ownership principles, such as those found in Section 318, should not be imported, the courts, prompted in large part by the statutory reference to indirect ownership and control, have not hesitated to apply attribution principles in determining whether the requisite ownership or control existed in a particular situation."

When F became co-executor of the estate of his deceased brother E, he became entitled to vote more than 50 percent of stock of S Company as previously indicated. While F did not at that time obtain ownership of more than 50 percent of the voting stock, it appears from the material quoted above that the fact of control alone should be sufficient for purposes of Section 25105. The material quoted above further indicates that the meaning of "control" is "broad and indefinite" and that "it is the reality of the control which is decisive." The reality here is that F, through his legal right to vote more than 50 percent of the stock of S Company, obtained control of the Company. This conclusion is evidenced by the facts that F, through his controlling votes, was elected president of the corporation and was able to purchase additional unissued shares sufficient to shift majority ownership from E's family (which held it for many years) to Fred's family.

From all of the foregoing, it is my opinion that F obtained direct or indirect control of more than 50 percent of the voting stock within the meaning of Section 25105 at the time he became co-executor of the Estate of E. Since F obtained control through the transfer of corporate stock occurring as a result of the death of E, there was, in my opinion, a change of ownership of property of S Company under Section 64(c).

EFF:fr